No. 15,998

IN THE

United States Court of Appeals

For the Ninth Circuit

JAMES R. YOST,
Appellant,

vs.

ALBERTA G. MORROW,
Appellee.

REPLY BRIEF OF APPELLANT.

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OPENING STATEMENT.

Inasmuch as the Appellee has in her brief raised new matter that was not pleaded and upon which no Finding of Fact or Conclusion of Law was based, we will reply at greater length than would ordinarily be the case.

The Appellee asserts that the Appellee Morrow was not a co-maker, joint-maker or accommodation-maker of the note in question. It is also asserted that the Appellee Morrow was properly dismissed from the action on the ground that the Appellant released the security without the consent of the Appellee Morrow. The latter contention was not pleaded nor was any Finding of Fact or Conclusion of Law submitted or entered in support of this contention. It is significant

that the Appellee's contention that she received no consideration and was not a co-maker, joint-maker or accommodation-maker is inconsistent with her own admission in her pleadings which, as we have discussed in our opening brief, is binding upon the Appellee. We refer to Proposition B of the Argument set forth in our opening brief (pp. 16-21). With the observation that the Appellee Morrow's admission that she made, executed and delivered the note in question for a valuable consideration would establish her liability at least as a joint-maker, co-maker or accommodation-maker.

We will address ourselves to the contention of the Appellee Morrow that the Appellant permitted the security to be dissipated without the consent of the Appellee Morrow.

ARGUMENT.

I.

EVEN IF WE CONCEDE, WHICH WE DO NOT, THAT THE APPELLEE MORROW IS NOW IN A POSITION TO ASSERT THAT THE APPELLANT PERMITTED THE SECURITY TO BE DISSIPATED WITHOUT THE CONSENT OF THE APPELLEE IT IS NEVERTHELESS AT ONCE APPARENT THAT COULD NOT WORK AN EXTINGUISHMENT OF THE DEBT AS CONTEMPLATED BY SECTION 120 OF THE UNIFORM NEGOTIABLE INSTRUMENTS ACT, SECTION 27-801, IDAHO CODE.

From an examination of the authorities it is at once apparent that the only kind of act on the part of the Appellant that could have discharged the Appellee Morrow under the Negotiable Instruments Law would have been an act that would have discharged both the

Appellee Morrow and the defendant Butcher; in other words, an act which would have discharged the entire obligation under the note. The Idaho Code, Section 27-801, cited by the Appellee in her brief, which is identical to Section 119 of the Negotiable Instruments Law, provides as follows:

"27-801. How instrument discharged. A negotiable instrument is discharged:

1. By payment in due course by or on behalf of the principal debtor.

2. By payment in due course by the party accommodated where the instrument is made or accepted for accommodation.

3. By the intentional cancelation thereof by the holder.

4. By any other act which will discharge a simple contract for the payment of money.

5. When the principal debtor becomes the holder of the instrument at or after maturity in his own right."

Apparently the Appellee fails to distinguish between an *endorser* and a *maker*. Insofar as a maker of a note is concerned, one can only be released if the act of the holder is such that it would discharge the entire obligation. This proposition is discussed at length by the Supreme Court of Montana in the case of *Merchants National Bank of Billings v. Smith,* 196 Pacific 523, 15 A.L.R. 437. In that case the Court was dealing with Section 119 of the Negotiable Instruments Law which is identical with Section 27-801, Idaho Code above quoted. At page 525 the Court dis-

cusses the situation here contended for by Appellee as follows:

> "But appellant contends that he is released by virtue of the provisions of subdivision 4 of this section, for if the note in question were a simple contract, the release of the securities by the bank would operate to discharge him. Section 119 relates only to the discharge of the instrument and not to the discharge of the parties, though the greater includes the less, and it never was the law that the release of a surety or accommodation maker discharged the instrument itself. Richards v. Bank, above.
>
> The meaning of subdivision 4 is apparent. Anything which will discharge, that is, destroy, a simple contract—literally blot it out of existence in contemplation of law—will discharge an accommodation maker, but it will also release the principal debtor, and all other parties liable thereon."

The statement of the Court seems to be in accord with the text authorities. See 10 C.J.S., page 1039, Section 476-C, Footnotes 1 and 2, subject, Bills and Notes.

From the foregoing authorities as well as a literal reading of Subsection 4 of Section 119 of the Negotiable Instruments Law it is obvious that the Appellee Morrow cannot be discharged from her liability by any alleged release of security by the Appellant. The Appellee Morrow was a maker of the note in question and was, therefore, primarily liable. Section 119 of the Negotiable Instruments Law cited by the Appellee in her brief and hereinbefore set forth is the only

section relating to discharge that could have any bearing on the instant case inasmuch as the Appellee Morrow is a maker of the note. A careful examination of that section of the Negotiable Instruments Law at once discloses that it relates to discharge of the instrument and not makers or endorsers.

We are not unmindful of the law with respect to persons secondarily liable and that in such a case defenses under the law of suretyship may be involved which, among other things, might permit the assertion of the defense in this case that the security had been released if in fact that were the case, which we do not concede. Such a defense under the law of suretyship can only be asserted by an *endorser* or a person secondarily liable. It does not apply to a maker even though it be established as between the accommodation-maker and his co-maker there existed the relationship of principal and surety. The law in this respect is very ably discussed by the Supreme Court of Colorado in the case of *Edmonston v. Ascough,* reported in 95 Pacific 313. In that case one maker of a note signed the note and placed after his signature the word "surety". After suit was commenced he sought to invoke defenses under the law of suretyship but was precluded by reason of the fact that he was a maker and not an endorser. The Court discusses the contention of the surety at page 314 as follows:

> "It is assumed that prefixing the word 'surety' to his signature brought him within the rules or regulations touching indorsers or guarantors of negotiable paper. But in this regard counsel are mistaken. The word 'surety' did not change the

nature of appellant's liability. His signature was attached at the time the instrument was made and before its delivery. It was written on the face of the note and below the name of the principal maker. If appellant did not actually participate in the consideration we are satisfied from the evidence that he nevertheless intended to assume the responsibility of a joint maker. We do not consider what the effect would have been under our negotiable instrument law, had appellant's name been indorsed in blank on the back of the instrument."

The law as above-stated is supported by text authority. It is stated in 10 C.J.S., page 464, Section 37-E, Bills and Notes, as follows:

"Makers may occupy the relation of principal and surety between themselves, but nevertheless be all principals as to the payee or the holder; and the holder is ordinarily not affected by agreements between the makers as to their respective liability. However, one may show, as against a payee not a holder in due course, that he signed only as a surety."

We are likewise aware that it might be contended that the Appellant as payee is not a holder in due course and we are aware that there is a split of authority as to whether or not a payee may be a holder in due course. Again we cite *Merchants National Bank of Billings v. Smith, et al.,* supra. In that case the Court after discussing and analyzing the several sections bearing upon this question, concludes on page 528 as follows:

"It seems necessary, in order to harmonize the several provisions of the act, to hold that the

> complete definition of 'negotiated' is contained in the first sentence of section 30, and that a payee who has taken a note, complete and regular upon its face, before it was overdue, and for value and in good faith, may qualify as a holder in due course and prima facie is such."

This is likewise the rule in Idaho. This case has twice been cited by the Supreme Court of Idaho and our Court has twice held that a payee of a negotiable instrument may become a holder thereof in due course under the provisions of the Negotiable Instruments Law.

Redfield v. Wells, 173 Pacific 640, 31 Idaho 415;

McLaughlin's Store v. Copeman, 294 Pacific 523, 50 Idaho 214.

It is elementary, of course, that one signing on the face of the note such as this is a maker. The law is clearly stated in the case of *Milner Bank & Trust Company v. Whipple's Estate,* by the Supreme Court of Colorado reported in 156 Pacific 1098. In that case the executors of one of the makers whose name appeared on the face of the note contended that that co-maker was a surety. The Court after holding that the executors had the burden of proof to sustain the contention that the maker was a surety held that the maker was liable as a joint maker. We quote from the syllabus of the Court:

> "One signing an instrument reciting that on demand 'we promise to pay' a sum stated, with interest, is liable as a joint maker."

The rule as there stated is likewise supported by text authority. See 10 C.J.S., page 462, Bills and Notes, Section 37.

II.

EVEN IF IT BE CONCEDED FOR THE SAKE OF ARGUMENT THAT THIS COULD BE A PROPER CASE FOR INVOKING THE DEFENSE OF THE LAW OF SURETYSHIP THAT THE APPELLEE MORROW WAS DISCHARGED BY RELEASE OF SECURITY IT WAS NEVERTHELESS INCUMBENT UPON THE APPELLEE MORROW TO PLEAD THAT DEFENSE AND TO CARRY THE BURDEN OF PROOF OF AFFIRMATIVELY SHOWING SURETYSHIP AND HER LACK OF KNOWLEDGE OF THE DISPOSITION BEING MADE OF THE MORTGAGED FEED IN QUESTION.

It is elementary that the burden of pleading the defense now asserted by the Appellee Morrow was upon her under the Federal Rules of Civil Procedure. Rule 8-C of the Rules of Civil Procedure provides as follows:

> "In pleading to a preceding pleading, a party shall set forth affirmatively accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servants, laches, license, payment, release, res judicata, statute of frauds, statute of limitations, waiver, and any other matter constituting an avoidance or affirmative defense. When a party has mistakenly designated a defense, the court on terms, if justice so requires, shall treat the pleading as if there had been a proper designation."

In view of the foregoing rule and in view of the further fact that the Appellee Morrow by her Answer admitted the execution and delivery of the note in question for a valuable consideration, she is not now in a position to assert for the first time that she was discharged by release of security. The execution of the note for a valuable consideration is completely inconsistent with the idea that she stood in the relation of surety to the defendant Butcher and as we have heretofore seen the Appellee could only assert this defense if she did stand in the relationship of surety to the defendant Butcher.

It is equally true that the Appellee Morrow had the burden affirmatively of proving the defense now asserted. The rule is stated in 11 Corpus Juris Secundum, page 111, subject, Bills and Notes, Section 663:

> "The burden of proving his defense is on a party to commercial paper who claims that he was released from liability thereon, or discharged by operation of law, as by an extension of time to the party primarily liable, or by negligence of the holder in failing to realize on securities;"

The rule as stated in Corpus Juris Secundum is amply supported by the case authorities. In the case of *Milner Bank and Trust Company v. Whipple's Estate,* supra, the executors of a deceased maker of a note contended that the deceased was only a surety and that she had been discharged. In that case the Court held that the burden of proof was on the executors and for failure to meet that burden the estate

of the decedent was held liable. The rule is stated in the syllabus of that case as follows:

> "Where plaintiff filed a claim against the estate of a decedent as the maker of a note, her executors, who contended that she was only a surety and that she had been discharged, have the burden of proof."

It is significant that this rule is recognized even in jurisdictions which hold that a payee is not a holder in due course and that a note is subject to the same defenses as if non-negotiable. See *Rennie v. J. I. Case Threshing Machine Company,* 220 Pacific 626. In that case the defendant was sued on a promissory note. By his Answer the defendant asserted certain defenses. The Supreme Court of Oklahoma at page 627 stated the rule as follows:

> "The effect of defendant's answer was to admit the execution of the notes and the amount sued for thereon, in the event the jury should find the issues of fact against the defendant on his answer. The burden was on the defendant to establish his defense by a preponderance of testimony."

III.

A DEFENSE OF DISSIPATION OF SECURITY IS WAIVED UNLESS RAISED BY PLEADING OR MOTION.

Rule 12-h, Federal Rules of Civil Practice and Procedure.

Section 12-h of the Federal Rules of Civil Practice and Procedure reads as follows:

> "Waiver of defenses. A party waives all defenses and objections which he does not present either

by motion as hereinbefore provided or, if he has made no motion, in his answer or reply, except (1) that the defense of failure to state a claim upon which relief can be granted, the defense of failure to join an indispensable party, and the objection of failure to state a legal defense to a claim may also be made by a later pleading, if one is permitted, or by motion for judgment on the pleadings or at the trial on the merits, and except . . ."

Clearly under this rule if any such defense as the Appellee is now contending for with respect to the fact that the mortgaged hay was fed by her co-defendant ever existed it was waived by her failure to raise it either by her Answer or by some appropriate Motion. It does not come within any of the exceptions in said Rule 12-h.

IV.

IN ORDER TO ASSERT THAT RELEASE OF SECURITY RELEASED THE APPELLEE MORROW IT IS NECESSARY TO SHOW THAT THE ACTIONS OF THE APPELLANT LEGALLY EFFECTED A RELEASE AND THAT IF THERE WAS IN LEGAL EFFECT A RELEASE OF SECURITY THAT IT WAS WITHOUT THE KNOWLEDGE OR CONSENT OF THE APPELLEE MORROW.

As has heretofore been pointed out, the only kind of release that can release the accommodation maker, co-maker or joint maker is such a release as would in legal effect extinguish the entire instrument. Even if we concede, which we do not, that a co-maker or accommodation maker may be released by acts of the payee, namely, by releasing the security, we find no

case cited by the Appellee which states that the feeding of mortgaged feed by one of the makers of a note constitutes a release of security that would release either the maker of the note or the accommodation maker. We have made an exhaustive search and find no cases which hold that the legal effect of allowing one maker of a note to be discharged or released by reason of the feeding of mortgaged feed by the other maker of the note. As a matter of fact it is significant that in the instant case the profits realized by the defendant Butcher under his feeding contract pursuant to which the mortgaged feed was fed was credited by the Appellant on the note.

Again, if we concede for the sake of argument that feeding the mortgaged feed by the defendant Butcher could work to legally effect a release of the accommodation maker, the Appellee Morrow, it was nevertheless incumbent upon the Appellee Morrow at the trial to plead and prove not only the now asserted release of security but also that such release of security was without the knowledge or the consent of the Appellee Morrow. From the record it cannot be assumed or inferred that the Appellee Morrow did not have knowledge or give her consent. When we consider the amount of money involved and that the fact of knowledge and consent would be within her knowledge and yet she remained silent we cannot logically conclude that she did not have knowledge or that she did not give her consent. On the contrary had she in fact not had knowledge nor had she given her consent it is obvious that such lack of knowledge and lack of consent would not only have been pleaded and proved but

by her asserted with great vehemence. We emphasize the necessity for a showing by the Appellee of a lack of knowledge and lack of consent because all of the cases cited by the Appellee in her brief, even those that are the most favorable to her position, have one thing in common that is lacking here, namely, that in each case the release of security was without the knowledge and without the consent of the accommodation maker.

V.

WHERE A PARTY POSSESSED OF KNOWLEDGE OF A PARTICULAR MATTER DOES NOT PRODUCE THE EVIDENCE THEREOF THERE IS A PRESUMPTION THAT THE EVIDENCE IF INTRODUCED WOULD BE ADVERSE TO SUCH PARTY.

Coeur d'Alene Lead v. Kingsbury, 85 Pacific (2d) 691 (Idaho);

State Ex Rel Good v. Boyle, 186 Pacific (2d) 859 (Idaho);

Lyon v. Melgard, 163 Pacific (2d) 1019 (Idaho).

The Appellee complains that the hay in question was fed out to her co-defendant's livestock. She did not testify as to whether her co-defendant, who was her son-in-law, told her about the contract he had with the Appellant for feeding livestock and that the hay in question was to be fed to these livestock under the terms of the written contract in evidence in this case. Neither did she testify as to whether or not she consented to such arrangement. This evidence was peculiarly within her knowledge and consequently her failure to testify creates a presumption that the evi-

dence if furnished would have been detrimental to her. It is hardly to be conceived that she would have signed a note for more than Eight Thousand Dollars even for her son-in-law without ascertaining the reason he wanted the money and what arrangement he had for repaying the note.

In conclusion we direct attention to the fact that the Findings of Fact and Conclusions of Law are silent with respect to the Appellee's present contention that she is discharged by a release of security. We furthermore direct attention to the fact that the Findings of Fact and Conclusions of Law justify the dismissal as to the Appellee Morrow solely upon the ground of lack of consideration. It is furthermore significant that the Appellee Morrow in her Answer admitted that she made, executed and delivered the note in question for a good and valuable consideration. As to the necessity for pleading the defense now asserted and the effect of admissions made in the pleadings we merely direct attention to Proposition B appearing in our opening brief on pages 16 through 20.

Summarized the Appellant's contentions are:

That the Appellee was an accommodation maker;

That by the pleadings she admitted she executed the note for a valuable consideration;

That the Appellee did not plead the defense of release of security (if such is a defense);

That the cases cited by the Appellee upon the question of release of security were all cases where the holder of the note released a mortgage or other lien

securing the payment of a note *without the knowledge or consent of the accommodation maker;*

That in the instant case the Appellant did not release any security;

That there is no evidence that the Appellee did not know or consent to the feeding of this hay by her co-defendant;

That her failure to testify as to whether she had knowledge of or had given consent to such feeding raises a presumption that if she had so testified the evidence would have been detrimental to her.

That the Appellee was a maker as distinguished from an endorser; that she could only be released by acts which would release and discharge the entire instrument as to both parties; that under the law of Idaho the Appellant payee was a holder in due course; that being primarily liable on the note as a maker the defense recognized under the law of suretyship of release of security was not available to the payee; that she did not in any event undertake to plead or prove the defense now asserted.

We respectfully urge, therefore, that the Appellee Morrow should not have been released and that the trial Court was in error in dismissing the action as to the Appellee Morrow.

Dated, Weiser, Idaho,
November 18, 1958.

Respectfully submitted,
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Attorneys for Appellant.